

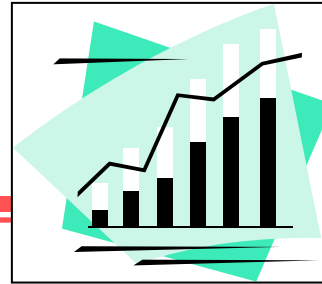
California Debt and Investments Advisory Commission
Mechanics of a Bond Sale

Developing a Debt Management Policy

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Plans and Policies



- Plans are good.
 - Any debt issuance should be preceded by longer-term financial and capital improvement plans
 - ❖ What do you plan to do, and why?
 - ❖ How do you plan to pay for it?
 - ❖ What's the “right” combination of pay-as-you-go versus debt financing?
- Policies are better.
 - Which is why we're covering them first!

Fiscal Health



- Fiscal health is a lot like your personal health—it's not what you live for but it's hard to enjoy your life without it.
- Like personal health, fiscal health is rarely luck.

Fiscal Policies



- The best way to ensure your long-term fiscal health.
 - Local economy important.
 - But not the most critical feature . . . financial management counts!
 - ❖ Just Think: Orange County
- Not only for the “good times” — may be more important in the “bad times.”

An Example of the Power of Policies

Fund Balance Survey: 1996

| City | Policy? | If Yes, Description | Actual |
|-----------------|---------|---------------------|--------|
| Arroyo Grande | No | | 1% |
| Atascadero | No | | 1% |
| Grover Beach | Yes | 20% of operating | 20% |
| Morro Bay | Yes | 27.5% of operating | 15% |
| Paso Robles | Yes | 15% of operating | 13% |
| Pismo Beach | No | | -14% |
| San Luis Obispo | Yes | 20% of operating | 21% |

Plans vs Policies

“Plans are nothing;
planning is everything.”

Dwight D. Eisenhower

- Plans change over time as actual results replace assumptions (like, as soon as the laser jet ink is dry).
- But policies:
 - Are your “north star” guiding preparation of plans.
 - Help making tough decisions easier by telling you what your values are before they are placed under stress by adverse circumstances.
 - You might actually do something else, but they are a powerful starting point:
 - ❖ *But for “this,” I would do . . . what?*

What Might Be Covered?

City of San Luis
Obispo Policy

- Balanced Budget (and what this means)
- Staff vs Council Budget Authority
- Financial Reporting
- Revenue Management
- User Fees
 - Taxes vs Fees
- Enterprise Funds:
 - Do they subsidize the General Fund?
 - Does the General Fund subsidize them?
- Revenue Earmarking
- Investments
- Appropriations Limit
- Minimum Fund Balance
- CIP Management
- Human Resources
- Contracting-Out
- Productivity
- ✓ *Capital Financing & Debt Management*

Debt Management Policies

- No right answers.
- Only right questions.

Basic Questions for Debt Policies

- Who prepares them?
- Who approves them?
- How detailed should they be?
- How often are they reviewed/updated?

GFOA Recommended Practices

- Conducted survey of debt policies, ranked by commonality.
 - Most common feature was the “purposes and uses for which debt may be issued.”
- Provides good benchmark for drafting your own.

Common Elements in Debt Policy Statements

- | | | | |
|----|---------------------------|----|-----------------------------------|
| 1 | Purposes and uses of debt | 19 | Sale process |
| 2 | Types of debt | 20 | Assessed value |
| 3 | Capital expenditures | 21 | Analysis requirements |
| 4 | Refunding bonds | 22 | Reserve capacity |
| 5 | Disclosure | 23 | Per capita limitations |
| 6 | Statutory limitations | 24 | Size of issuance |
| 7 | Project life | 25 | Intergovernmental coordination |
| 8 | Rating agency relations | 26 | When not to issue debt |
| 9 | Operating budget | 27 | Operating revenue |
| 10 | Revenue and TIF bonds | 28 | Lease debt |
| 11 | Bond rating goals | 29 | Capitalized interest guidelines |
| 12 | Misc. limitations | 30 | Market value limitations |
| 13 | Repayment provisions | 31 | Credit enhancement |
| 14 | Maturity guidelines | 32 | Limited tax GO bonds ¹ |
| 15 | General fund revenue | 33 | Inter-fund borrowing |
| 16 | Expenditure limitations | 34 | Variable rate debt |
| 17 | Professional services | 35 | Debt service funds |
| 18 | Short-term debt | 36 | Derivatives |

¹In California, effectively a lease obligation

Fitch Rating Agency: Mgt Practices

■ Very Significant

- Fund balance policy
- Debt affordability policy

■ Significant

- Pay-as-you-go capital financing
- Multi-year forecasting
- Quarterly reporting
- Quick debt retirement

■ Influential

- Contingency plans
- Non-recurring revenue policy
- Depreciation of fixed assets (GASB 34 implementation)
- 5 Year CIP integrating operating cost impacts
- GFOA financial reporting award
- GFOA budgeting award

Report is included in your binders

Standard & Poor's Top Ten Practices

- Established budget reserve
- Regular economic and revenue reviews
- Prioritized spending plans and established contingency plans
- Formal capital improvement plan
- Long-term planning
- Debt affordability model
- Pay-as-you-go financing
- Multi-year financial plan
- Effective management and information systems
- Well-defined and coordinated economic development plan

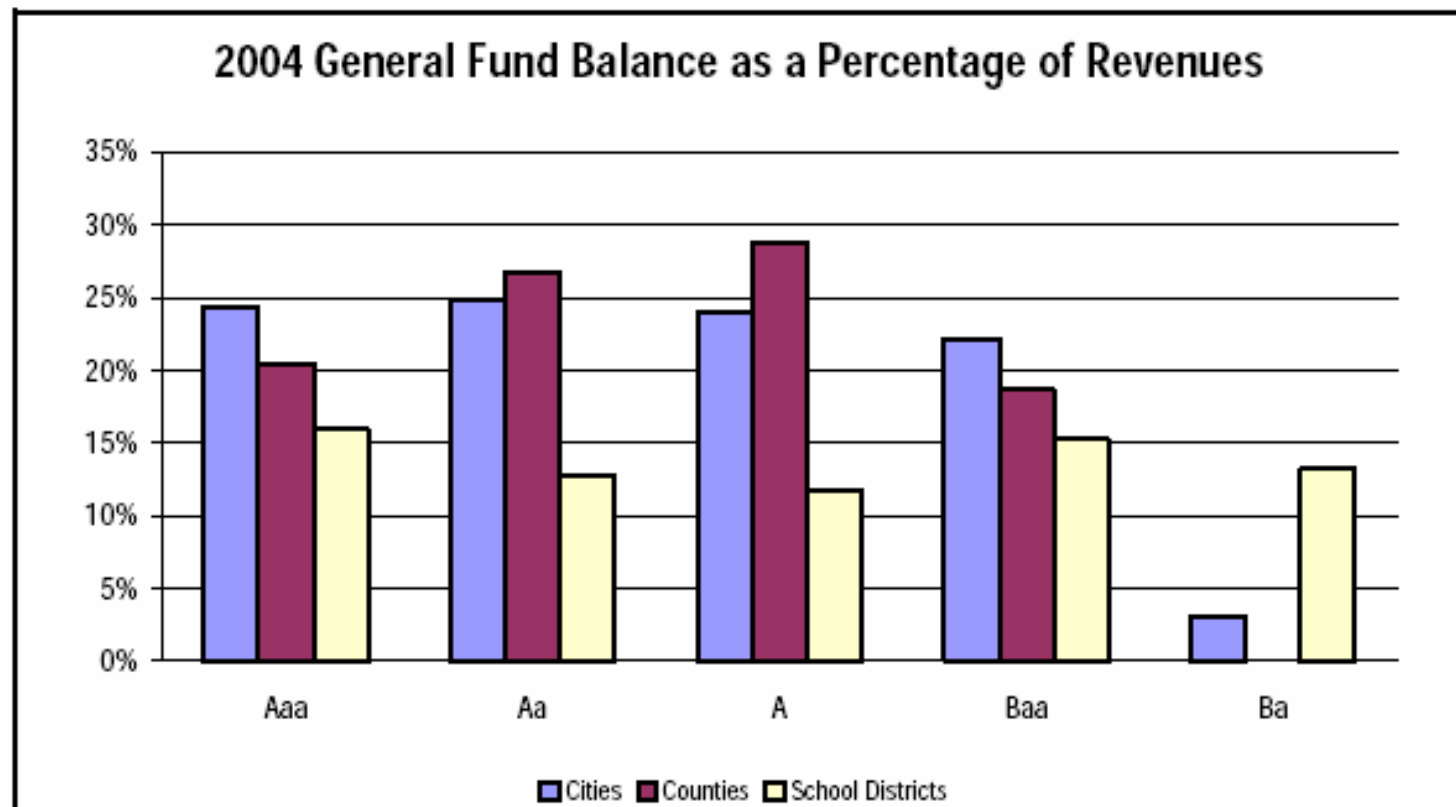
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Where to Start? Other Agencies

- Moody's has prepared a report on national averages of cities, counties and school districts for key "ratios."

Report is included in your binders

Fund Balance Ratios



Key Ratios: All Cities

| Municipal Financial Ratio Analysis - U.S. Cities (All) | |
|--|------------------|
| Selected Medians | National Medians |
| Median Moody's GO/Issuer Rating | A2 ¹ |
| General Fund Balance as % of Revenues | 26.20 |
| Unreserved, Undesignated General Fund Balance as % of Revenues | 17.20 |
| Direct Net Debt as % of Full Value | 1.10 |
| Debt Burden (Overall Net Debt as % Full Value) | 2.70 |
| Total Full Value (\$000) | \$1,307,283 |
| Full Value Per Capita (\$) | \$70,962 |
| Population 2000 Census | 15,931 |
| Per Capita Income (2000 Census) | \$22,160 |
| <i>(1) Median rating of A2 is lower than in 2004 Local Government Medians report due to the expansion of the sample size as Moody's continued to populate MFRA during 2004 and 2005.</i> | |

Cities Between 50,000 and 100,000

Ratios By Credit Rating

| Municipal Financial Ratio Analysis - U.S. Cities (50,000 < Population < 100,000) | | | | | |
|--|---------------------------------------|-------------|-------------|-------------|-------------|
| Selected Medians | Group Medians (Most Recent Available) | | | | |
| | Aaa | Aa | A | Baa | Ba |
| General Fund Balance as % of Revenues | 29.00 | 26.80 | 20.70 | 7.20 | 3.10 |
| Unreserved, Undesignated General Fund Balance as % of Revenues | 15.90 | 20.40 | 13.00 | 3.20 | 1.20 |
| Direct Net Debt as % of Full Value | 0.80 | 1.10 | 1.10 | 2.90 | 11.00 |
| Debt Burden (Overall Net Debt as % Full Value) | 2.00 | 2.80 | 3.00 | 4.30 | 12.70 |
| Total Full Value (\$000) | \$9,888,184 | \$4,968,200 | \$3,486,831 | \$2,741,904 | \$1,232,353 |
| Full Value Per Capita (\$) | \$148,969 | \$73,804 | \$53,377 | \$34,963 | \$22,167 |
| Population 2000 Census | 64,742 | 66,237 | 59,643 | 71,329 | 61,821 |
| Per Capita Income (2000 Census) | \$37,582 | \$23,242 | \$20,058 | \$16,488 | \$15,721 |

One City's Approach: San Luis Obispo

- Included as an integral part of our two-year Financial Plan and Budget
 - Approved by the Council
 - Reviewed at least every two years, but ongoing as needed
- Organization
 - General Management Policies
 - Focused Debt Policies

City's policies are included in your binders

Debt Management Policies (SLO)

- Capital financing: Clear bias towards pay-as-you-go.
- Only consider debt financing when:
 - One-time project (lumpy cost).
 - High priority project.
 - Use life exceeds financing term.
 - Adequate resources to cover debt service.
 - Not for recurring purposes or ongoing maintenance.
 - ❖ *Exception: Short term notes for cash flow (Trans).*

Source of Funding (SLO)

- Whenever specific beneficiaries can be identified, use:
 - Service fees
 - Enterprise funds
 - Assessments
 - Developer agreements
 - Impact fees (special note on these: what about timing and cash flow?)
- General purpose debt supported by General Fund revenues is “last resort.”

Criteria (SLO)

- Factors Favoring Pay-As-You Go
 - Current sources are adequate and available.
 - Current debt is too high.
 - Market conditions are not favorable.
 - Ongoing capital maintenance: It isn't a "lumpy" cost.

Criteria (SLO)

■ Factors Favoring Debt Financing

- Long-term revenues are adequate to support debt service costs.
- Project will support investment grade credit rating.
- Favorable market conditions.
- Project required by federal or state government, and current sources are inadequate.
- High-priority project that is needed immediately to address capacity, and current sources are inadequate.
- Life of project or asset is ten years or longer.

Debt Management (SLO)

- Avoid obligating the General Fund.
- Prepare internal feasibility analysis for each issue: impact on current and future budgets and City services.
- General bias: Conduct financings on competitive basis.
- Seek investment grade ratings.
- Review debt as part of budget process.
- Diligently monitor compliance with covenants and regulations.
- Maintain good ongoing communication with rating agencies.

Debt Capacity: General Fund

- Debt capacity is limited, so make it count:
 - Funds borrowed for a project today can't be used for other projects tomorrow.
 - Funds committed for debt repayment today can't be used to fund services tomorrow.
- Long-term capital planning is the key to managing debt capacity.

Debt Capacity: General Fund

- Determining “capacity” is an art not a science.
 - You can probably borrow as much as you want, but with deteriorating credit and increasing interest rates.
 - Determine capacity policy that is appropriate for you.
 - For some agencies, the capacity number becomes the floor; in others, actual is sustained below capacity target.

Debt Capacity: General Fund

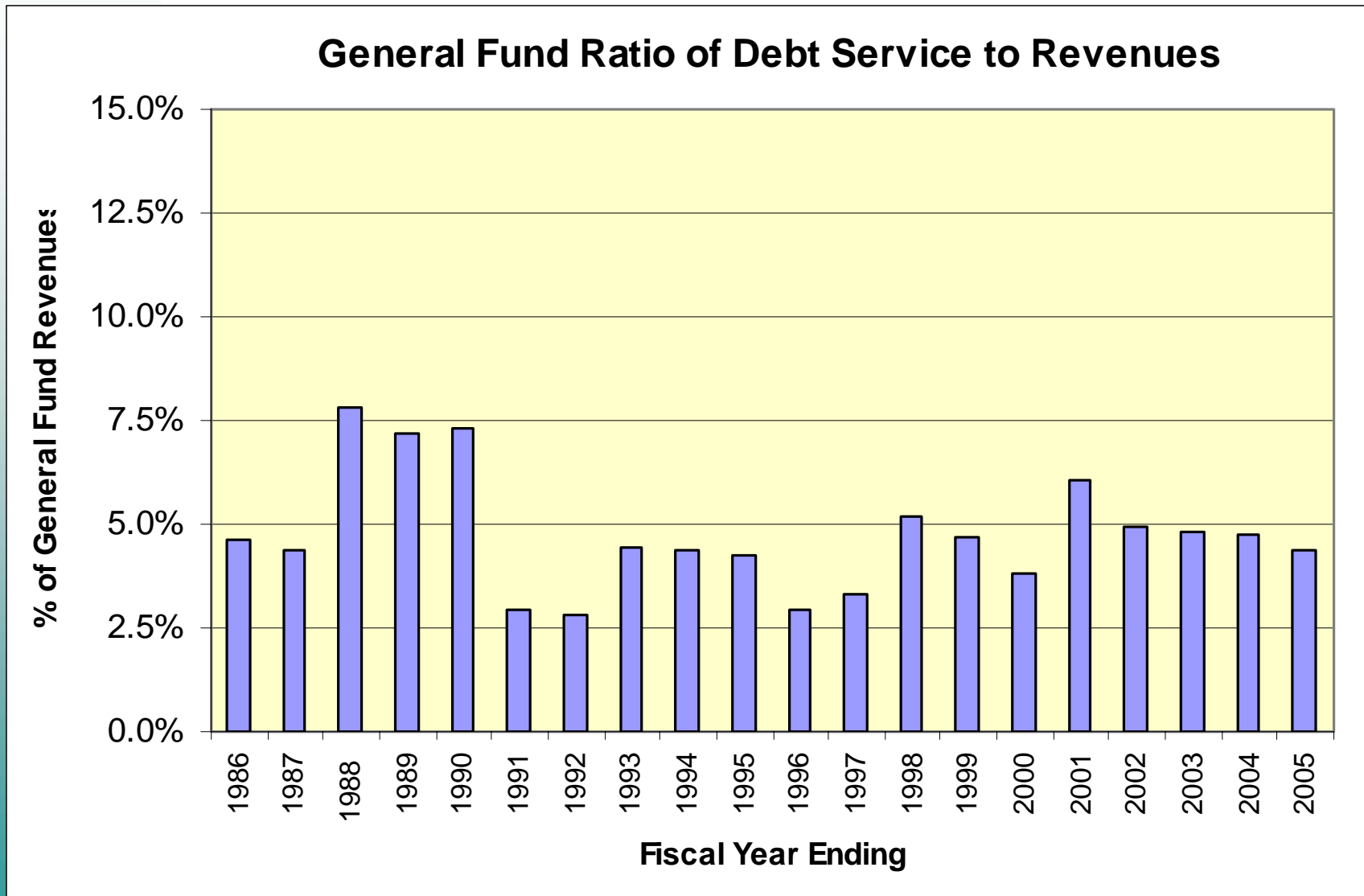
- Capacity in policies is often based on standard ratios:
 - Debt as % of assessed valuation.
 - Debt per capita.
- For General Fund debt, debt service as % of revenues or expenditures is common measure.
 - 5% to 10% is within “normal” range.
- Determine how to treat self-supporting debt.

Debt Capacity: General Fund (SLO)

■ Guidelines

- Annual debt service should generally not exceed 10% of operating revenues; and never exceed 15%.
- Total direct debt should not exceed 2% of assessed value.
- No more than 60% of four-year CIP will be funded from long-term debt.

Debt Service Ratios (SLO)



Debt Capacity: Enterprise Funds

- **SL0:** Whatever we're willing to set rates at as needed to fully cover cost of operations, maintenance, CIP, administrative (including indirect costs) and debt service (including any coverage requirements).
- Capacity can be more limited if your rates are high compared to other jurisdictions.

Refundings

- Standard rule of thumb is to achieve present value savings of 3% to 5% of refunded bond issue.
 - You can only do one “advance refunding;” make it count.
 - Higher savings appropriate if period to call is long.
 - Restructuring opportunity?
 - Yield curve management.
- San Luis Obispo
 - Consider at 3%.
 - ❖ *Compelling public purpose if less than 3%.*
 - Do at 5%.

Financing Team

- SLO looks for long-term relationships with our:
 - Financial Advisor
 - Bond Counsel
 - Trustee
- Many agencies do RFP's on a case-by-case or programmatic basis.

Investment of Bond Proceeds

- Who
 - In-house?
 - Investment Advisor?
- General Strategy Questions

Other Common Features

- Maturity guidelines
- Bond features
 - Optional redemption (call)
- Variable rate debt

Not addressed in SLO policy

Land-Based Financings (SLO)

- Clear Public Purpose
- Active Role by City
- Applicant Credit Quality
- Reserve Fund
- Capitalized Interest
- Value-to-Lien Ratio
 - 4:1
 - 3:1 in exceptional circumstances
- Maximum Burden
- Benefit Apportionment
- Special Tax District Administration
- Foreclosure Covenants
- Disclosure to Bond Holders
- Disclosure to Prospective Purchasers

Conduit Financings (SLO)

- Case-by-case review
 - Clearly articulated public purpose.
 - Applicant is capable of achieving this purpose.
 - City's bond counsel reviews financing and renders opinion no liability to City.
- Generally, this means a two-step process:
 - Council considers request and determines any follow information needs.
 - Staff returns with review results.
- Workscope will vary.
- Should generally be reimbursed for all costs.
- Try to get another agency to actually issue bonds.

Summary



- Policies Are Powerful
 - Fundamental foundation for long-term fiscal health: underlying basis for case-by-case decision-making.
 - Provides context for what you would “but for.”
 - Essential component of any “contingency plan.”
 - Articulates your values before they are under stress.

Questions?

